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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

SHEARN MOODY, JR.,
Petitioner,

v.

DAVID C. MEYERS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the federal courts in this case should have abstained from deciding claims that collaterally attacked determinations made by state insurance regulators.
2. Whether the court of appeals exceeded its authority by declaring principles of general law at variance with governing state law.
3. Whether the principles set forth in *Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad*, 417 U.S. 703 (1974), barring the use of the federal courts to obtain windfall recoveries, are inapplicable to windfalls for which the plaintiffs ostensibly bargained.

PARTIES TO THE PROCEEDING

This litigation was commenced by the filing of two shareholders' derivative suits. Plaintiffs in the first suit, suing on behalf of Empire Life Insurance Company of America and Credit Factoring, Inc., were Bernard Haines, Louis Mast, William Sosniak, and Jack Sosniak. Named as defendants were Shearn Moody, Jr., Empire Life Insurance Company of America, and Credit Factoring, Inc. Plaintiffs in the second suit, suing on behalf of Empire Life Insurance Company of America, were David C. Meyers, Frank Habicht, and Peter N. Todhunter. Named as defendants were Shearn Moody, Jr.; Clay Cotton, Commissioner of Insurance for the State of Texas; Tom I. McFarling, temporary receiver for Empire Life Insurance Company of America; E. V. Omholt, Montana receiver of Empire Life Insurance Company of America; John G. Bookout, Alabama receiver of Empire Life Insurance Company of America; E. Gene Sykes, Arkansas receiver of Empire Life Insurance Company of America. These suits were eventually dismissed. The remaining suit was filed by John G. Bookout, as statutory receiver on behalf of Empire Life Insurance Company of America, against Shearn Moody, Jr.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Shearn Moody, Jr., petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINION BELOW

The opinion of the court of appeals is reported at 693 F.2d 1196. The opinion is reprinted as Appendix A in the separate Appendix to this petition. The opinion of the district court is reported at 475 F. Supp. 232. It is reprinted as Appendix B in the separate Appendix to this petition.

JURISDICTION

The judgment of the court of appeals was entered on December 23, 1982. The court of appeals denied a petition for rehearing and rehearing *en banc* on March 1, 1983. On May 12, 1983, Justice White extended the time for filing a petition for a writ of certiorari to and including June 20, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT

This lawsuit was filed against petitioner, a former majority stockholder, director and officer of Empire Life Insurance Company, seeking to impose liability for certain activities ordered or approved by the Alabama Department of Insurance.[1] After a jury verdict for respondent, the district court entered a judgment against petitioner for $5,319,000 in compensatory damages and $1,000,000 in punitive damages. The court of appeals affirmed.

The events giving rise to the suit began in 1963. In June of that year, petitioner incorporated Empire Life Insurance Company ("Empire") in the State of Alabama. Pet. App. 3. The following month, petitioner assigned to Empire 40 per cent of his interest in the Libbie Shearn Moody Trust, a trust whose principal asset was nearly ten million shares of stock in American National Insurance Company.[2] In return for that interest, petitioner received an unpaid debenture for $200,000. Pet. App. 3.

The valuation of the trust interest lies at the heart of the dispute. Under Alabama law, as in other states, the valuation of assets of an insurance company is the responsibility of the Department of Insurance. 28 Ala. Code § 61 (1959); Ala. Code §§ 27-37-1 *et seq.* (1977). While an insurance company must provide the Department with financial statements and other necessary information, the Department of Insurance must ultimately determine the extent of liabilities and the availability of assets to cover them. In 1964, Alabama law provided that "[t]he superintendent of insurance shall allow to the

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[1] The complaint alleged claims under the federal securities laws, as well as state claims. Jurisdiction over the state claims, the only claims on which the court of appeals grounded liability, was predicated on theories of pendent jurisdiction and diversity jurisdiction.

[2] American National Insurance Company was, and is, one of the largest stock life insurance companies in the United States. See DX 37.

credit of an insurance company, in the account of its financial condition, on such assets as are or can be made available for the payment of losses in Alabama." 28 Ala. Code § 61 (1959).

The valuation of a life interest is a mixture of art and science. Since a life interest terminates, of course, on the death of the beneficiary, the first variable to be considered is the age of the beneficiary and, with the guidance of actuarial tables, his life expectancy. The evaluator must then determine the likely stream of income to be received during the term of the life estate, a calculation that in this case involved projections regarding future dividend distributions from American National Insurance Company. Once this figure has been calculated, it must be discounted for the effects of inflation in order to arrive at a present value. See Pet. App. 4. After consideration of these factors, the Superintendent in 1964 valued the life interest held by Empire at $5,813,440. Pet. App. 4-5.

Early in 1965 American National Insurance Company announced an increase in its dividend. Pet. App. 5. Since that increase changed one of the variables for determining the value of the trust interest, Empire provided the Department of Insurance with revised figures showing a range of different values for the trust interest. After these figures were reviewed by Alabama insurance examiners, a formal valuation hearing was held before the Superintendent of Insurance. Pet. App. 7-8. The Superintendent then determined that the life interest should be valued at a figure of $14,213,440. DX 6.[3]

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[3] Throughout its opinion the court of appeals mistakenly says that the Superintendent placed a value of $14,403,200 on the life interest, strongly implying that he adopted one of the figures submitted to him by the Company. See, e.g., Pet. App. 7, 10, 15, 21, 22, 37 and DX 64. In fact, after his own review of the figures, the Superintendent placed a lower value on the life interest, which Empire subsequently observed. DX 6.

This figure remained unchanged for the next three years, during which time Empire made numerous acquisitions. The Department of Insurance, as required by Alabama law, reviewed each of the acquisitions to determine whether they jeopardized the financial stability of the Company. For these purposes, the Department continued to value the life interest at the $14 million figure. Each of the acquisitions was approved by the Department. See e.g., DX 43A, DX 44, DX 47.

Had these events been the extent of the story, no lawsuit would have ensued. But in 1969, an appraisal prepared by the American Appraisal Company suggested alternative valuations for the life interest of $8,600,000 (for continued use) and $4,250,000 (for orderly liquidation). Pet. App. 10. A second Superintendent of Insurance rejected those figures, issuing an administrative order expressly authorizing Empire to carry the life interest at an asset figure of $14.2 million. DX 19.[4] In 1972, however, a third Superintendent revived the earlier appraisal and ordered that the life interest be carried at a figure of $4,250,000, a revision that caused Empire to become insolvent under statutory accounting principles. Pet. App. 11. The Superintendent made no finding that the life interest was incorrectly valued in 1965, concluding only that, as of the date of his determination, a different value was appropriate.

Thrown into financial convulsion by the sudden change in valuation, Empire was placed into receivership in June 1972. Pet. App. 11. Eighteen months later, the receivership court ordered that Empire be liquidated and approved a bulk reinsurance agreement with Protective Life Insurance Company ("Protective"). Pet. App. 11.

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[4] The order, noting that petitioner's life expectancy decreased as he got older, provided for the establishment of a reserve fund to be increased annually and required the maintenance of adequate insurance on petitioner's life. DX 19.

This lawsuit, instituted on behalf of Empire in 1974,[5] in essence attacks the decision to value the life interest at $14 million and to pursue a series of acquisitions based upon that figure. Although petitioner has consistently noted that the valuation was set, and the acquisitions approved, by the Alabama Department of Insurance, the district court declined to defer to those judgments, electing to consider the reasonableness of such actions on a *de novo* basis. The jury thus heard expert testimony on much the same issues as the Superintendent of Insurance had resolved years before. Apparently concluding that the higher valuation and the subsequent acquisitions had been unreasonable, the jury awarded over six million dollars in damages under federal and state law. Pet. App. 12.

The court of appeals took the same approach. Putting aside the claims under federal law, the court concluded that the valuation and subsequent acquisition program were sufficient to sustain common law claims of mismanagement and breach of fiduciary duty. Pet. App. 20-25. Like the district court, the court of appeals gave no weight to the fact that the Alabama Department of Insurance had made the determinations at issue. Rather, the court fashioned its own rule to govern the case, stating: "An insurance company may not delegate responsibility for valuation of its assets to a state agency, and the mere fact that an insurance commissioner accepts a company's asset valuation does not immunize the company from liability arising from that valuation." Pet. App. 22 n.11.

The court also declined to apply the principles of *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad*

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[5] Two shareholders' derivative suits were brought on behalf of Empire in 1972. After this derivative action was filed, with the Receiver serving pursuant to Alabama statute (Ala. Code § 27-32-15(a) (1975)), the shareholders' actions were dismissed. Pet. App. 12 & n.7.

Co., 417 U.S. 703 (1974), to this case. Although this Court in *Bangor Punta* disapproved the use of federal courts to secure windfall profits, the court of appeals concluded that *Bangor Punta* was inapplicable where the plaintiff had bargained for the windfall. Pet. App. 16-18.

REASONS FOR GRANTING THE WRIT

The decision of the court of appeals, while set in the framework of an action for damages, is in fact a collateral attack on several determinations committed by state law to the Alabama Department of Insurance. During the period from 1965-1970, the Department not only concluded that Empire Life Insurance Company was entitled to carry an assigned life interest on the books for $14.2 million but then approved a series of acquisitions by Empire based upon that figure. No challenges to those decisions were made then or later in the Alabama courts. Instead, respondent filed a suit in federal court for damages nine years after the valuation and six years after the last acquisition, claiming that the valuation and acquisitions were unreasonable. The courts below, showing little or no deference for the role of the State agency, agreed.

This belated judicial review suffers from several defects. To begin with, in declaring that companies (and their officers and directors) may be found liable for decisions made by state agencies, the court of appeals has introduced a rule of law that will unsettle relations between businesses and state officials for years to come. Even more importantly, the decision puts the federal courts in the role of second-guessing the decisions of state administrators, a role for which they are ill-situated and ill-suited. This seizure of authority is particularly inappropriate here for it occurs in the complex field of insurance regulation, which Congress has emphatically entrusted to the primary care of the states.

We believe that the decisions of this Court counsel a different course. See, *e.g.*, *Fair Assessment in Real Estate*

Ass'n, Inc. v. McNary, 454 U.S. 100 (1981); *Alabama Public Service Comm'n v. Southern Ry. Co.*, 341 U.S. 341 (1951); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). In such cases, the Court has held that federal courts should refrain from exercising jurisdiction where its exercise would intrude on state regulation of essentially local matters. See also *Hawks v. Hamill*, 288 U.S. 52 (1933). By the same token, the Courts of Appeals for the First and Second Circuits have recognized that abstention is particularly appropriate in the area of insurance. See *Allstate Insurance Co. v. Sabbagh*, 603 F.2d 228 (1st Cir. 1979); *Smith v. Metropolitan Property & Liability Insurance Co.*, 629 F.2d 757 (2d Cir. 1980). The same deference to state regulation should have been accorded here.

We also believe that, even if jurisdiction was properly exercised, the court of appeals improperly applied law of its own invention. It is well-established, of course, that a federal court exercising pendent or diversity jurisdiction over state claims must apply state law in the same manner as a state court would do. See *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). Despite these principles, however, the court of appeals felt free to fashion its own rule, directly contrary to state law, that determinations by state administrative agencies could be set aside in a private suit for damages. This judicial lawmaking flies in the face of nearly fifty years of decisions by this Court forbidding federal courts to create "federal common law" in pendent and diversity cases.

Finally, the court of appeals devised a novel exception to the principles set forth by this Court in *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co.*, 417 U.S. 703 (1974). Although the Court made clear in *Bangor Punta* that the federal courts should not be used to obtain windfall recoveries, the court of appeals found those principles inapplicable to windfalls for which the plaintiff had ostensibly bargained. The exception is unwarranted and unwise.

I. The Decision Below Is Inconsistent With Decisions Of This Court And Other Courts Of Appeals Requiring Deference To State Administration of State Programs.

Whether phrased in terms of comity, abstention, or equitable discretion, this Court has long emphasized "[t]he scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts." *Matthews v. Rogers*, 284 U.S. 521, 525 (1932); *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, *supra*, 454 U.S. at 111. In setting aside state determinations, and imposing liability on petitioner for acting in accordance with those determinations, the courts below showed no such "scrupulous regard."

The requirement of deference to state activities, as the Court has recently noted, is grounded in a "continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways." *Younger v. Harris*, 401 U.S. 37, 44 (1971), quoted in *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, *supra*, 454 U.S. at 112. Faced with repeated invitations to disregard or discredit state efforts, "federal courts must be constantly mindful of the 'special delicacy of the adjustment to be preserved between federal equitable power and State administration of its own law.'" *Rizzo v. Goode*, 423 U.S. 362, 378 (1976), quoting *Stefanelli v. Minard*, 324 U.S. 117, 120 (1951). "It is in the public interest that federal courts of equity should exercise their discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states." *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298 (1943).

Even where the jurisdiction of the federal courts has been invoked for the advancement of federal rights, this Court has warned against needless intrusion into state programs. Thus, the Court has admonished that "the National Government, anxious though it may be to vindicate

and protect federal rights and federal interests [should] always endeavor[] to do so in ways that will not unduly interfere with the legitimate activities of the States." *Younger v. Harris, supra*, 401 U.S. at 44. This admonition, of course, applies with even greater force when the rights asserted are not federal rights at all but rights based on state law. As Justice Cardozo has written for the Court, "[r]eluctance there has been to use the process of federal courts in restraint of state officials though the rights asserted by the complainants are strictly federal in origin. * * * There must be reluctance even greater when the rights are strictly local * * *." *Hawks v. Hamill, supra*, 288 U.S. at 61.

These principles are more than historical musings. In putting these principles into effect, this Court has ordered the outright dismissal of certain cases thought particularly intrusive on local concerns. See *Burford v. Sun Oil Co., supra*; *Alabama Public Service Comm'n v. Southern Ry. Co., supra*. In *Burford*, for example, the Court ordered that a challenge to a drilling order of the Texas Railroad Commission be dismissed, observing that "it 'is in the public interest that federal courts of equity should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy.'" *Id.* at 318, quoting *Commonwealth of Pennsylvania v. Williams*, 294 U.S. 176, 185 (1935). Noting that Texas had a fully adequate administrative and judicial scheme for challenging such orders, the Court stated: "These questions of regulation of the industry by the State administrative agency * * * so clearly involve basic problems of Texas policy that equitable discretion should be exercised to give the Texas courts the first opportunity to consider them." 319 U.S. at 332. Similarly, in *Alabama Public Service Commission*, the Court held that "[a]s adequate state court review of an administrative order based upon predominately local factors is available to appellee, intervention of a federal court is not necessary for the protection of federal rights."

341 U.S. at 349. Pointing to the "usual rule of comity," the Court concluded that "[w]hatever rights appellee may have are to be pursued through the state courts." *Id.* at 350. See also *Louisiana Power & Light Co. v. Thibodaux*, 360 U.S. 25 (1959); *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976).[6]

There is, of course, no bright line to separate activities of particular importance to the states from other activities deemed less important. But, at this point in the history of federal-state relations, it is virtually beyond dispute that regulation of insurance companies, the matter at issue here, is a subject of unusual sensitivity to the states. As the Court has recognized, for at least 75 years prior to 1944, "regulation of insurance transactions was thought to rest exclusively with the States." *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453, 458 (1969). After the decision in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), which cast doubt upon the issue, Congress promptly passed the McCarran-Ferguson Act, 59 Stat. 34 (1945), as amended, 15 U.S.C. § 1011 *et seq.*, to reaffirm the primary role of the states in regulating the business of insurance. That role has continued essentially undiminished to the present time.[7]

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[6] While these principles generally evolved in cases seeking equitable or declaratory relief, this Court has recently made clear that they apply to suits for damages as well. In *Fair Assessment in Real Estate Ass'n, Inc. v. McNary, supra*, the Court reasoned that the determinations necessary to sustain an action for damages "would be fully as intrusive as the equitable actions that are barred by principles of comity." *Id.* at 113. The Court pointed out that "damages actions, no less than actions for an injunction, would hale state officers into federal court every time a taxpayer alleged the requisite elements of a § 1983 claim." *Id.* at 115. The controlling question in every case, therefore, is not whether the suit seeks damages or an injunction but whether it needlessly interferes with regulatory or other activities of particular importance to the state.

[7] The McCarran-Ferguson Act leaves little doubt about the limits of federal intervention into insurance matters. In its first section,

The decision of the court of appeals in this case does considerable violence to these policies. Without any effort to divine actual or likely state law on the subject, the court first announced a rule that administrative determinations do not affect the liability of companies relying on them. Pet. App. 22 n.11.[8] To make matters worse, it proceeded to reopen the questions decided by the state agency, ultimately concluding that the decisions were erroneous. Pet. App. 22. As a result, petitioner has been subject to liability on legal grounds that have no identifiable basis in state law and on factual grounds that are in conflict with findings of a state agency.[9] This judicial venture has effectively made the state decisions meaningless.

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for example, Congress expressly declared that "the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011. The Act then provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance * * *." 15 U.S.C. § 1012(b). This Court in *National Securities* observed that "[t]he relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the 'business of insurance.'" 393 U.S. at 460. The issue of valuation of assets, in turn, goes directly to the question of the "reliability" of a company's insurance policies, since it determines what assets are considered to be available for the payment of claims.

[8] Rejecting arguments to the contrary as "spurious," the court stated: "An insurance company may not delegate responsibility for valuation of its assets to a state agency, and the mere fact that an insurance commissioner accepts a company's asset valuation does not immunize the company from liability arising from that valuation." Pet App. 22 n.11. The court cited no authority for this proposition.

[9] Although the Department of Insurance later required the life interest to be carried at a lower valuation (see page 4, *supra*), it did not attempt to revise the earlier valuations retroactively. It is the *retroactive* change in valuation, supplied by the court of appeals, that is at issue here.

The legal questions decided by the court of appeals, far from being peripheral issues, lie at the heart of the state regulatory process. If it is true that "[a]n insurance company may not delegate responsibility for valuation of its assets to a state agency," as the court of appeals declared, then the final word on valuation of assets must necessarily rest with the insurance companies themselves, not the state agencies. In that case, it might naturally follow that, as the court of appeals also concluded, "the mere fact that an insurance commissioner accepts a company's asset valuation does not immunize the company from liability arising from that valuation." But, if those issues are decided the other way, and the decisions of the state agency are deemed controlling, then the balance of responsibility shifts markedly. It is just that sort of issue that the state courts, rather than the federal courts, are better positioned to decide.[10]

It scarcely helps matters that the views of the court of appeals are almost certainly wrong. Even a cursory reading of state law shows clearly that the Alabama Department of Insurance is, and long has been, given ultimate responsibility for the valuation of assets. 28 Ala. Code § 61 (1959); Ala. Code §§ 27-37-1 *et seq.* (1977). Since state law has imposed that duty, no delegation from the companies is needed or even possible. Once a valuation has been set, the companies are then bound to respect that valuation and may be subject to shareholder suits if they let assets languish.

We also believe that the state courts would be far more likely to support agency findings in the face of collateral attack. Even where direct attacks are concerned, for example, Alabama law requires that an order of the Insurance Commissioner "be taken as just and reasonable."

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[10] This Court, of course, has also recognized that uncertainty about state law is an independent reason justifying abstention. See, e.g., *Railroad Comm'n of Texas v. Pullman*, 312 U.S. 496 (1941); *Louisiana Power & Light Co. v. Thibodaux, supra.*

Ala. Code § 27-2-32 (1975). Furthermore, "[i]t is an accepted principle that [t]he rule which forbids the reopening of a matter once judicially determined by competent authority applies as well to the judicial and quasi-judicial acts of public, executive, or administrative officers and boards acting within their jurisdiction as to the judgments of courts having general judicial powers." *State v. Brooks*, 53 So.2d 329, 333 (Ala. 1951) (internal quotes omitted). See also *City of Huntsville v. Goodenrath*, 68 So. 676 (Ala. 1915). Since the acts of the Alabama Commissioner are expressly made quasi-judicial, Ala. Code § 27-2-31(a) (1975), we seriously doubt whether the Alabama courts would recognize a cause of action for damages based on a claim that earlier factual determinations of the Commissioner were unreasonable.[11] At the very least, the Alabama courts should have the opportunity to make that choice for themselves.[12]

The evils of the court of appeals' rule are well demonstrated in this case. While the suit did not directly challenge the actions of the Alabama Department of Insurance, the claims in the end invited the federal courts to determine that those actions were wrong.[13] It is undisputed that the events giving rise to this lawsuit were the valuation of the life interest in 1965 and a series of acquisitions from 1965-1968 (see Pet. App. 14); it is

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[11] At one point, the court of appeals seems to imply that it would permit imposition of liability even if the administrative determinations were *reasonable*. Pet. App. 22-23. Again, no authority is cited for this proposition and, so far as we are aware, none could be.

[12] Alabama law on these points is hardly out of step with other jurisdictions. See cases cited at note 19, *infra*. Indeed, in a case quite similar to this one, a three-judge federal court held that an administrative determination was binding even on subsequent *administrators* and that it could not be collaterally attacked. *Modern Woodmen of America v. Casados*, 17 F. Supp. 763 (D.N.M. 1937).

[13] As the court of appeals itself noted, "there was only one wrong complained of and proved: the manipulation of the life interest leading to fatal undercapitalized acquisition * * *." Pet. App. 27.

likewise undisputed that the Department of Insurance, after review by its examiners and a hearing on valuation, decided to admit the life interest at a value of $14.2 million and that the Department subsequently approved each of the challenged acquisitions. Pet. App. 7-8; DX 6, DX 43A, DX 44, DX 47.[14] Yet, notwithstanding these administrative decisions and the absence of any challenge to those decisions in state court, the court below felt free to conduct a *de novo* review of the wisdom of the determinations and to conclude that they were "unreasonable." Pet. App. 22. This sort of second opinion suspends insurance companies between competing factfinding bodies.

Had the 1965 valuation or the later acquisitions prompted a direct and immediate challenge in federal court, we think that the principles of noninterference established in *Burford* and *McNary* would have required its dismissal. See also *Allstate Insurance Co. v. Sabbagh*, *supra*, and *Smith v. Metropolitan Property & Liability Ins. Co.*, discussed at pages 16-17, *infra*. It should hardly benefit respondent that, instead of filing an immediate direct challenge, it chose to make a collateral attack in the form of an action for damages some nine years later. To begin with, as the cases cited above indicate (see page 13, *supra*), it is well recognized that a collateral attack may not do service for a direct appeal or act as a way around neglected procedural requirements. But, in any event, the interference with state regulatory efforts is, if anything, even greater in such a case since a suit for damages not only requires a finding that the administrative deter-

[14] The court of appeals does make the gratuitous suggestion that the Superintendent of Insurance "might have been swayed by considerations of friendship and obligation in approving the increased valuation of the life interest." Pet. App. 8 n.4. In so surmising, however, the court ignored not only the established presumption that officials act in a proper manner (*see, e.g., United States* v. *Chemical Foundation, Inc.*, 272 U.S. 1, 14-15 (1926)), but also the fact that a subsequent Superintendent reached the same conclusion despite the submission of other possible valuation figures. See page 4, *supra*.

minations were wrong but exacts an after-the-fact penalty for acting on the basis of those determinations. Indeed, it is to prevent this sort of uncertainty that both Alabama and Texas have required challenges to insurance rulings to be made in a single, specified state court. See Ala. Code § 27-2-32 (1975) ("circuit court of Montgomery County, Alabama"); Texas Ins. Code Ann. art. 1.15, § 4 (Vernon 1981) ("any state district court located in Travis County, Texas").[15]

The intrusion on state regulation might be worth the cost if the federal courts had something particular to contribute, but the reverse is true. It merely states the obvious to say that the federal courts have no notable expertise in valuations for insurance purposes. As the opinion of the court of appeals aptly demonstrates, the valuation of a life interest depends upon choices made among a number of variables, including life expectancy, projected income streams, and anticipated inflation rates. See Pet. App. 4. In concluding that the trust interest was overvalued, the court of appeals simply advanced its own view, with the not inconsiderable benefit of hindsight, on the proper resolution of an issue resolved differently by the Department of Insurance seventeen years before.[16]

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[15] The presence of the unaddressed federal securities claims does not change our view. The intrusion on state affairs would be just as great, for example, if a stockholder sought to challenge an administrative valuation by suing the insurance company for including that valuation on its balance sheet. We see no reason why the federal courts in such a case should have a license to force insurance companies to choose, at their peril, between an administrative finding and a judicial one.

[16] For example, the court of appeals relied, among other things, on "ANICO's subsequent earnings history" as support for a more conservative valuation. Pet. App. 22. The court also announced its view that "the $14,403,200 valuation was clearly unreasonable in relation to the life interest's income," Pet. App. 22, although the same figures regarding trust income were before the Superintendent when he made his determination that the $14 million figure *was* reasonable. We also note that in the period from 1964-75, Empire re-

Whether or not the court of appeals is right, a point on which experts may eternally differ, the fact remains that the substitution of federal judges for state administrators turns the regulation of insurance companies on its head.

The willingness of the Fifth Circuit to meddle in these issues is in marked contrast to the position taken by the First and Second Circuits. See *Allstate Insurance Co. v. Sabbagh*, *supra*; *Smith v. Metropolitan Property & Liability Ins. Co.*, *supra*. See also *Construction Aggregates Corp. v. Rivera de Vicenty*, 573 F.2d 86 (1st Cir. 1978); *Barry v. St. Paul Fire and Marine Ins. Co.*, 555 F.2d 3 (1st Cir. 1977), aff'd, 438 U.S. 531 (1978). In *Sabbagh*, for example, the First Circuit upheld, on the basis of *Burford v. Sun Oil Co.*, *supra*, the decision to abstain from a challenge to automobile insurance rates established by the Massachusetts Commissioner of Insurance. The court noted that, like the courts in *Burford* and *Alabama Public Service Commission*, it was "dealing with an area of intensely local interest." 603 F.2d at 233. Furthermore, it observed that, as was the case here, "[t]his case would inevitably involve detailed factual analysis of the bases of the Commissioner's decision and [plaintiff's] efforts to prove the Commissioner's decision unjustified." *Ibid.* The court concluded that any such review could be better conducted by the state courts. *Id.* at 233-34.[17]

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ceived nearly $2.5 million in dividends from the life interest, *Empire Life Insurance Co. v. Moody*, 584 S.W.2d 855, 859 n.2 (Tex. 1979), and it has received substantially more since then.

[17] The First Circuit in *Construction Aggregates* also took special care not to create avenues of relief in federal court where none would exist in state court. The court observed: "[Appellant] has not cited any statute or authority granting to the Puerto Rico courts jurisdiction to entertain an attack on an Insurance Fund rate in any other manner. If the laws of Puerto Rico do not recognize a cause of action permitting a collateral attack on these rates, a federal court in the exercise of its diversity jurisdiction would be unable to enter-

The court in *Smith* followed a similar course, upholding the decision to abstain in a suit challenging the validity of an exclusionary clause in an automobile insurance policy. First noting that state law on the issue was unclear, the court went on to emphasize that the state had a vital interest "in the doctrinal integrity of its regulatory scheme." 629 F.2d at 760. The court pointed out that federal interference might have "a severe disruptive impact on the state regulatory apparatus," *id.* at 761, finally concluding: "The fact that the insurance industry is heavily regulated makes it all the more important that we stay our hand in favor of a definitive and uniform interpretation from the state courts. Abstention is particularly appropriate when dealing with a complicated and comprehensive regulatory statute intended to strike a balance between differing local interests." *Id.* at 761 (internal quotes and citations omitted).[18]

In valuing the assets of an insurance company, state regulators necessarily must "strike a balance between differing local interests." If assets are valued too high, the protection afforded to policyholders will be eroded. On the other hand, if assets are undervalued, the ability of insurance companies to provide insurance coverage,

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tain any such claim." 573 F.2d at 96. The court of appeals in the present case made no effort at all to determine whether the Alabama courts would permit a suit of this sort.

[18] These cases strongly suggest that the mischief of the decision below, while ample in its own right, cannot readily be confined to this particular case. For, if a plaintiff may seek damages in federal court based upon his disagreement with agency determinations, then the true effect of agency decisions cannot be known until such suits are finally resolved. Thus, for instance, an insurance company might become subject to class actions by policyholders for charging rates previously approved by state regulators or to suits for enforcing policy exclusions allowed by state regulators, even though no direct challenge to such rates or exclusions had ever been made in state court. In light of such continuing uncertainty, it will become increasingly difficult for states to establish a coherent system of insurance regulation.

and thereby compete for insurance customers, will be arbitrarily cut back. Thus, in addition to the usual difficulties associated with valuing assets, insurance commissioners must decide, on grounds of policy, whether they will tolerate certain risks in exchange for more extensive competition. Once those choices have been made, they should not be subject to either direct or collateral attack in federal court.

This is plainly a case where "intervention of a federal court is not necessary for the protection of federal rights." *Alabama Public Service Comm'n v. Southern Ry. Co., supra*, 341 U.S. at 349. The decision to exercise jurisdiction was thus an improper interference with state efforts to regulate insurance companies.

II. The Court Of Appeals Improperly Substituted Its Own Views For The Applicable State Law.

Even if the courts below properly decided to exercise jurisdiction, they were required to apply state law to the state law claims. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). Yet, on the crucial question regarding the 1965 valuation, the court of appeals seemingly made no effort to do so, instead announcing its own erroneous view that state factfinding does not affect the liability of insurance companies.[19] This casual lawmaking is pre-

[19] The Court's sweeping and summary disposal of the pivotal question of law (see note 8, *supra*), while perhaps an eloquent statement of its sense of what the law *ought* to be, flatly contradicts what the States of Texas and Alabama have decreed that the law *shall* be. In Texas (whose law the court of appeals generally applied on other questions) collateral attacks on agency determinations, in private suits for damages and otherwise, are forbidden. *Bolton v. Coats*, 514 S.W.2d 482 (Tex. Civ. App. 1974); *Railroad Commission v. McKnight*, 619 S.W.2d 255 (Tex. Civ. App. 1981); *Railroad Commission v. Marathon Oil Co.*, 89 S.W.2d 517 (Tex. Civ. App. 1935); *Kirby Lumber Co. v. Adams*, 62 S.W.2d 366 (Tex. Civ. App. 1933). The law in Alabama is to the same effect. See cases cited at page 13, *supra*. Not even by alleging that an administrative finding was procured by the defendant's own false statements as evidence

cisely the sort of judicial enterprise that *Erie* was intended to stop.

Few legal principles have been stated as plainly as the principle established in *Erie:* "[t]here is no federal common law." *Id.* at 78. Not only does Congress "ha[ve] no power to declare substantive rules of common law applicable in a state * * *," *id.* at 78, but "no clause in the Constitution purports to confer such a power upon the federal courts." *Id.* at 78. Rather, this Court instructed that "[e]xcept in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state." 304 U.S. at 78.

The reasons for the rule are many and various. To begin with, the so-called "general law" of the federal courts often has amounted to "little less than what the judge advancing the doctrine [thought] at the time should be general law on a particular subject * * *." *Baltimore & Ohio R.R. v. Baugh*, 149 U.S. 368, 401 (1893) (Field, J., dissenting). In addition, creation of general principles introduces a lack of uniformity into the law, making the effects of commercial transactions more uncertain and the incentives to forum-shopping more seductive. 304 U.S. at

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can a plaintiff prevent a defendant from "relying on the order as a shield of liability." *Bolton v. Coats, supra*, 514 S.W.2d at 487.

As the Texas Attorney General pointed out in his *amicus* brief supporting a rehearing *en banc*, the court of appeals' "non-delegation" language was simply a way of phrasing a rule of law directly contravening the Texas and Alabama rules. *Brief Amicus Curiae of the State of Texas in Support of Appellant's Suggestion for Rehearing En Banc* at 6-7. "It is the state, acting pursuant to its responsibility to protect the public, that delegates responsibility for the valuation of assets. The insurance companies do not delegate any responsibility; insurance regulators value assets because the law of the state *requires* them to, not because the company *requests* them to." *Id.* at 7 (emphasis in original). The proposition that the court of appeals rejected as "spurious" was not a proposition invented by petitioner; rather, it was the law that would have been applied had this case been brought in state court.

74. Finally, the imposition of federal common law injures not only private litigants, but the states themselves, and hence the structure of constitutional government. As Justice Field had observed many years before *Erie*, "nothing can be more disturbing and irritating to the states than an attempted enforcement upon its people of a supposed unwritten law * * * to which they have never assented and which has no existence except in the brain of the Federal judges in their conceptions of what the law of the states should be on the subjects considered." *Baltimore & Ohio R.R. v. Baugh*, *supra*, 149 U.S. at 403 (Field, J., dissenting).[20]

The decision of the court of appeals here simply returns the allocation of lawmaking power to its condition before *Erie*. Although the court obviously did not disavow *Erie*, its statement of a broad general principle, without any grounding in or reference to state law, produces the same practical result. If the court of appeals had carefully considered the relevant state authorities, and if it had then rejected them as "spurious" on the ground that they conflicted with a general rule that "an insurance company may not delegate responsibility for valuation of its assets to a state agency," it would clearly have violated *Erie* and the Constitution. Since the basis for *Erie* is that the federal courts lack *jurisdiction* to make law,

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[20] Indeed, perhaps the most significant aspect of the decision in *Erie* was its formal recognition that the Constitution can be violated by the conduct of the federal courts themselves, independent of any unconstitutional legislative or executive actions. *Erie Railroad Co. v. Tompkins*, *supra*, 304 U.S. at 79-80; see C. Wright, Handbook on the Law of Federal Courts § 56 at 259 (3d ed. 1976). "It is impossible to overstate the importance" of this holding, which "announces no technical doctrine of procedure or jurisdiction, but goes to the heart of the relations between the federal government and the states, and returns to the states a power that had for nearly a century been exercised by the federal government." C. Wright, *supra*, § 55 at 255.

except where jurisdiction has been delegated by the Constitution and by Congress, a covert or careless usurpation of state lawmaking power is no less unconstitutional than an open and intentional one.

The damage done by the usurpation here is particularly acute because it transfers decisionmaking authority from an administrative agency to a court. In deciding that the Alabama Insurance Commissioner shall decide on the value of insurance company reserve assets, the State of Alabama chose to delegate this authority to an accountable public official chosen for specialized knowledge and competence in the insurance field. By decreeing that his findings can be overridden by a federal court, the court of appeals transferred decisionmaking power to a body whose members are chosen without any regard for their knowledge of the insurance industry, and who are given life tenure precisely so that they will not be politically accountable. Even if it were preferable for decisions about insurance regulation to be made by life-tenured generalists rather than by politically-accountable specialists, a proposition that we doubt, the point is that the transfer of decisionmaking power is a substantial one that restructures Alabama's regulatory scheme in important ways. If, as petitioner contends, the court below had no authority under state law to effect such a transfer, then its decision to do so is a serious error that deserves correction.

Although it may be presumed that federal courts often make common law by simply erring in their reading of state law, this case involves more than a mere misstep. Here, the court of appeals did not even attempt to apply state law to the question on which the case turned. That disregard is particularly inappropriate in this case for not only are there relevant authorities but they mandate the opposite result. See note 19, *supra*. Finally, we

note that the manner of ignoring state law—sweeping aside contentions about the specific positive law of a state with a general statement about what the law must be—suggests a return to precisely the judicial attitudes and habits that *Erie* condemned.

These departures can ultimately be curtailed only by this Court. This Court recognized recently in *Milwaukee v. Illinois*, 451 U.S. 304, 317 n.9 (1981), that "[s]ince the states are represented in Congress but not in the federal courts, the very concerns about displacing state law which counsel against finding pre-emption of *state* law in the absence of clear intent actually suggest a willingness to find congressional displacement of *federal* common law." In this case—where the issue is whether a federal court has displaced state lawmakers in an area incontestably outside the legitimate scope of federal common law—the same concerns should prompt a broad willingness by this Court to review and scrutinize claims that the federal courts have exceeded their constitutional authority.

The Court, in fact, exhibited precisely that willingness in several cases decided after *Erie*. In those cases, the Court readily reversed decisions by federal courts that, while acknowledging the obligation to apply state law, in fact decided crucial points without reference to applicable state decisions. See *Texarkana v. Arkansas Louisiana Gas Co.*, 306 U.S. 188 (1939), and *Equitable Life Insurance Co. v. Halsey*, 312 U.S. 410 (1941). In *Texarkana*, for example, the court of appeals had found it "perfectly plain" that a certain contract clause was "completely invalid and unenforceable as an attempt to abdicate and delegate" a legal duty. 97 F.2d at 9. This Court, however, reversed on the ground that the "perfectly plain" proposition had been decisively rejected by the Texas Supreme Court. 306 U.S. at 201-02. Similarly, the court of appeals in *Equitable Life* cited no state cases for its

pivotal holding but simply declared: "We see no reason why appellant should be held accountable," since a certain clause in a contract "constituted a valid defense." This Court again reversed, noting that the Supreme Court of Iowa had held otherwise. 312 U.S. at 423-426. The lesson of *Erie*, then, is that the federal courts must in fact apply state law, not merely pay lip service to it.

The tendency of federal courts to invent their own law has continued to occupy the attention of this Court. For example, the Court recently recognized and attempted to curtail the use of broadly-worded federal statutes as devices for the transformation of federal courts into courts of general common law. In *Parratt v. Taylor*, 451 U.S. 527 (1981), this Court rejected a lower federal court's attempt to enact the principle that "loss should not go without redress" into a federal law imposing liability on state officials under 42 U.S.C. § 1983. While suggesting that this axiom "would be an admirable provision to be contained in a code," the Court observed that there is "no general common law applicable to federal courts" and that the case must be resolved "not simply with a single, general principle, however just that principle may be in the abstract, but with the complex interplay of the Constitution, statutes, and the facts which form the basis for this litigation." *Id.* at 531-32. Similarly, in *Paul v. Davis*, 424 U.S. 693 (1976), this Court rejected any construction of the Due Process Clause that would "make of the Fourteenth Amendment a font of tort law to be superimposed upon whatever systems may already be administered by the states." *Id.* at 701. It would make little sense to allow federal courts, constrained by admonitions against replacing state tort law with their own preferred general principles under the authority of the Constitution or a federal statute, to accomplish exactly the same result under the rubric of interpreting state law.

III. The Decision Below, by Allowing Respondent A Duplicative Recovery, Is Inconsistent With The Decision Of This Court In *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co.*, 417 U.S. 703 (1974).

As the court of appeals has recognized, the recovery in this case will go, not to Empire, but to Protective Life Insurance Company. Pet. App. 17. Since Protective has already reaped the benefit of acquiring Empire's assets under the auspices of the receivership, the judgment here is precisely the sort of windfall condemned in *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co., supra.*

In *Bangor Punta*, this Court struck down a suit by a corporation against its former owner, where "the real party in interest and the principal beneficiary of any recovery" was the new owner of the corporation. In explaining why such a suit could not go forward, the Court relied on the "settled principle of equity that a shareholder may not complain of acts of corporate mismanagement if he acquired his shares from those who participated or acquiesced in the allegedly wrongful transactions." 417 U.S. at 710. As the Court stated, this broad rule applies "with special force where a shareholder purchases all or substantially all the shares of a corporation from a vendor at a fair price, and then seeks to recover *against that vendor* for prior corporate mismanagement." *Id.* (emphasis added).

The Court noted that a verdict for the plaintiff under such circumstances would produce two complementary inequitable results. First, the new owner of the corporation would receive a "windfall," because he would have paid a depressed price for the company due to the prior mismanagement, and then would also have received, through the corporation's suit, compensation for that mismanagement, which injured him not at all. *Id.* at 711-12.[21] Second, where the defendant was also the former

[21] The need to prevent new shareholders from "reap[ing] a profit from the wrongs done to others," *id.* at 711, may be viewed as the

sole or majority shareholder, that defendant would be doubly punished for his wrongdoing. As *Bangor Punta* recognized, 417 U.S. at 172, when such a shareholder mismanages a company, he does the injury, as it were, to himself. *See also In Re REA Express Inc., Private Treble Damage Antitrust Litigation*, 412 F.Supp. 1239, 1252 (E.D. Pa. 1976). Since that self-inflicted injury is reflected in the depressed sale price received, *id.*, a subsequent lawsuit can only have the "practical effect" of requiring the former owner to "pay twice" for his wrongdoing. See *National Union Electric Corp. v. Matsushita Electric Industrial Co.*, 498 F. Supp. 991, 1002 (E.D. Pa. 1980).

Those principles come into full play here. Just as in *Bangor Punta*, petitioner is a former majority owner of a company, facing a lawsuit for mismanagement brought in the name of the corporation by its new "owner." [22] Here, under the reinsurance agreement between the receiver and Protective, the role of the nominal corporate plaintiff is merely as a conduit because the contract guarantees that the bulk of any lawsuit proceeds will pass through the corporation and go directly to Protective. Thus, the real beneficiary in this case, as in *Bangor Punta*, is simply seeking to recover for alleged corporate

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central purpose of the *Bangor Punta* rule. *Rock River Savings and Loan Association v. American States Insurance Co.*, 594 F.2d 633, 635 (7th Cir. 1979). It is a need that comes into play whenever a company is sold for a price that is depressed due to previous misconduct and the buyer then seeks to recover for that misconduct. *E.g., id.*; *Courtland Manor, Inc. v. Leeds*, 347 A.2d 144, 148 (Del. Ch. 1975).

[22] In *Bangor Punta*, of course, that owner was a purchaser in a conventional stock sale, whereas, here, petitioner lost his interest in Empire Life through a combination of a receivership and a reinsurance agreement transferring the policies and assets to a competitor (Protective). Yet this difference does not alter the fundamental fact that each case includes a real party in interest *other* than the named corporate plaintiff. And it is clear that a reinsurance agreement is effectively a "sale." *Kentucky Central Life Insurance Co. v. Commissioner*, 57 TC 482, 496 (1972).

mismanagement when the same mismanagement was the basis for its acquisition on depressed terms. That recovery would seem to be a windfall of the purest sort.

The court of appeals, however, declined to apply *Bangor Punta*, finding an exception where the buyer ostensibly "bargained for" the litigation proceeds. Pet. App. 17-18. We do not believe that any such exception exists. Although one court has recognized that a buyer and seller may include a valuable cause of action in their calculations of the appropriate price, that court properly limited the exception to cases in which the cause of action lies *against third parties*, not the former owners of the company. *National Union Electric Corp. v. Matsushita Electric Industrial Co.*, *supra*, 498 F. Supp. at 1002. Indeed, any broader exception would make little sense. It will surely be the rare case where a seller of a corporation sells with it a right to sue himself for an unknown and unknowable amount of damages. And even if, for some reason, the effects of mismanagement were a separate item for discussion, it would be far more desirable to have a rule that requires the buyer and seller to decide the price of such mismanagement through negotiation, or through arbitration, than by agreeing to institute or extend litigation in the federal courts.

In any event, the exception fashioned by the court of appeals is wholly inapplicable to this case. While the court apparently believed that the policyholders of Empire would be the beneficiaries of the recovery, the jury expressly found that the policyholders suffered no injury. Interrogatory No. 11. Thus, not one cent of the judgment is intended to reimburse the policyholders. Moreover, it is now clear that the policyholders will not get one cent since any obligation of Protective to pay them has ended.[23] It is Protective, and Protective alone, that the judgment will enrich.

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[23] It is now a matter of public record that Protective has no obligation to pay any of the recovery to policyholders of Empire. See *Protective Corporation Annual Report, 1982, at 24.*

CONCLUSION

The petition for a writ of certiorari should be granted.

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